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STAFF PAPER

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Project	**IAS 21—*The Effects of Changes in Foreign Exchange Rates***		
Paper topic	Foreign currency translation of revenue		
CONTACT(S)	Hannah King	hking@ifrs.org	+44 (0)20 7246 6961

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Introduction

1. The IFRS Interpretations Committee (the 'Interpretations Committee') received a submission asking how to determine which exchange rate to use when reporting revenue transactions denominated in a foreign currency in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*. In particular, the submission described a circumstance in which the customer paid for the goods or services in advance.

2. The key points arising in the paper are:

   (a) the staff conclude that IAS 21 is not entirely clear whether revenue should be recognised using the exchange rate at the date of advance payment or at the date of recognition of the revenue;

   (b) our outreach indicates that the issue affects a number of jurisdictions and that there is diversity in practice; and

   (c) the staff recommend that the Interpretations Committee should add the issue to its agenda with a view to developing an Interpretation.

3. This paper provides:

   (a) a summary of the issue in the submission and alternative views;

   (b) an overview of outreach obtained;

(c) the staff's technical analysis, with a question for the Interpretations Committee;

(d) the staff's agenda criteria assessment; and

(e) the staff's recommendation.

4. The paper asks the Interpretations Committee whether it agrees with the staff's technical analysis and whether it agrees with the staff recommendation to take the issue onto its agenda.

The issue in the submission

5. The submitter illustrates the issue with the following scenario:

(a) an entity enters into a sales contract at time T0 with a customer for delivery of goods or services, payment for which is denominated in a foreign currency;

(b) a non-refundable payment for the contract is received in advance at time T1; and

(c) at a later date (T2), the entity transfers the goods or services to the customer.

6. The submitter asks which exchange rate should be used to recognise the revenue in profit or loss under such a contract in the entity's functional currency in accordance with IAS 21.

7. The relevant paragraphs in IAS 21 require that:

(a) A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction (paragraph 21 of IAS 21).

(b) The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with IFRSs (paragraph 22 of IAS 21).

8. For the purposes of this issue and throughout the rest of this paper, it is assumed that:

   (a) deferred revenue is a non-monetary item in accordance with paragraph 8 of IAS 21, and hence is not subsequently retranslated. This is because the advance payment is non-refundable in our example, to highlight the specific issue raised by the submitter; and

   (b) the entity does not hedge any aspect of the transaction.

9. For further details, please refer to the original submission in Appendix A.

Alternative views

10. The submitter has put forward three views for the situation in which there is a revenue contract with a non-refundable payment in advance of performance:

    (a) View A—revenue is recognised using the exchange rate at the date the contract is entered into or the date the contract becomes enforceable if later (ie at time T0);

    (b) View B—revenue is recognised using the exchange rate used to recognise the related deferred revenue on receipt of the cash prepayment (ie at time T1); and

    (c) View C—revenue is recognised using the spot rate at the date of recognition of the revenue (ie on transfer of the goods or services) (ie at time T2).

11. These views are all discussed below. In addition, Appendix B contains a simple illustrative example that highlights the differences in accounting treatment under the different views.

View A–revenue is recognised using the exchange rate at the date the contract becomes enforceable

12. Under View A, revenue is recognised using the exchange rate at the date on which an enforceable contract is entered into, or the date the contract becomes enforceable if later. In the simple example in paragraph 5 above, the spot

exchange rate at time T0 would be used to recognise both deferred revenue on the balance sheet and revenue in profit or loss.

13. Supporters of View A note that an enforceable executory contract contains a right and an obligation to exchange economic resources.[1][2] They argue that entering into such a contract is the date at which the transaction 'first qualifies for recognition'. This is regardless of whether such contracts are recorded in the balance sheet or whether payment is in advance or in arrears of the transfer of the goods or services.

14. This approach treats the whole contract as 'the transaction': that is, entering into the contract, receipt of the payment, and transferring the goods or services are treated as one unit of account for the purposes of determining the date of the transaction. This is because of their interdependency.

View B—revenue is recognised using the exchange rate used to recognise the related deferred revenue on receipt of the cash prepayment

15. Under View B, revenue is recognised using the exchange rate used to recognise the related deferred revenue on receipt of the cash prepayment (ie at time T1).

16. This view is based on the principle that the transaction first qualifies for recognition when the transaction is first recorded *with a value* in the financial statements, which is generally only when one of the parties to the contract first performs. If cash is received first, the spot rate on that date is used to recognise deferred revenue and, subsequently, revenue. Conversely, if the entity performs first, the revenue is recognised at the spot rate at the date of recognition of the revenue, being the date of the transfer of the goods or services. Hence, if payment is in arrears, the accounting treatment is the same as in View C below.

17. This view treats the receipt of the advance payment (which leads to the recognition of the obligation to transfer the goods or services as deferred revenue),

[1] Paragraph 3 of IAS 37 defines executory contracts as contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

[2] Appendix A of IFRS 15 defines a contract as 'an agreement between two or more parties that creates enforceable rights and obligations'.

and the subsequent transfer of goods or services by the entity, as one transaction, rather than separate transactions.

18. For payments received in advance of the transfer of goods or services, no foreign exchange gains and losses are recognised in profit or loss. This reflects the fact that the entity is no longer exposed to foreign exchange risk after receiving an advance cash payment. (If payment is received in arrears, foreign exchange gains and losses will arise on the trade receivable as a monetary item, from the date of recognition of the revenue until settlement.)

19. Under this view, the exchange rates used to recognise revenue depend upon whether the cash is received in advance and, if so, the timing and frequency of those payments made by the customer.

View C—revenue is recognised using the spot rate at the date of recognition of the revenue

20. Under View C, revenue is recognised using the spot rate at the date of recognition of the revenue (ie on transfer of the goods or services at time T2). This is regardless of whether the payment is in advance or arrears. When revenue is recognised over time rather than at a point in time, different rates may apply to the revenue portions recognised in different periods.

21. In this scenario, if payment is received in advance, deferred revenue is recognised using the spot rate at the date of the advance payment. The difference between the deferred revenue balance and revenue recognised in the income statement at T2 that is due to movements in the exchange rate (between T1 and T2) is recognised as exchange gains or losses in the income statement at T2.

22. Those in favour of this view argue that transferring the goods or services to the customer is a transaction in its own right and therefore first qualifies for recognition when it meets the recognition criteria in accordance with IAS 18 *Revenue*, IAS 11 *Construction Contracts* or IFRS 15 *Revenue from Contracts with Customers*. For performance obligations satisfied over time, the transaction therefore 'first qualifies for recognition' in increments over the performance period.

Outreach

23. We sent outreach requests to securities regulators, members of the International Forum of Accounting Standard-Setters and the IFRS technical teams of the international networks of the large accounting firms.

24. We asked the following questions:

    (a) In your jurisdiction(s) are you aware of any entities that have significant contracts with customers that are denominated in a foreign currency where there is a significant period of time between entering into the contract; payment (whether in advance or in arrears); and performance under the contract (ie rendering of services or delivery of goods).

    If so, please give examples that you have seen in practice, briefly explaining the prevalence and circumstances of those cases.

    (b) If you answered 'yes' to Question (a), please could you explain which of the following exchange rates have been used in practice to record the recognition of revenue in the income statement and the basis for using such a rate for each of the examples identified in Question (a) above:

        (i) the spot exchange rate at the date the executory contract was entered into;

        (ii) the spot exchange rate at the date the entity receives a cash payment in advance of its performance obligations under the contract;

        (iii) the spot exchange rate at the date the entity recognises revenue in the income statement, noting whether payment is in advance or arrears; or

        (iv) any other exchange rate (please provide additional details).

    (c) Are you expecting your answer to Question (b) to change on adoption of IFRS 15 and, if so, how and why?

Summary of outreach

25. We received 19 responses from: 6 large accounting firms; 11 national standard-setters (3 from Europe; 6 from Asia-Oceania; 1 from North America and 1 from Africa); and 2 securities regulators.

Question 1: How common are such transactions?

26. Fourteen respondents were aware of entities that have significant contracts with customers that are denominated in a foreign currency, and in which there is a significant period of time between entering into the contract; payment; and transfer of goods or services.

27. Many respondents thought that the issue was common across a number of jurisdictions. Some respondents indicated that the issue may be common in Russia, in other countries of the CIS, Thailand, Taiwan, Korea, Japan, and Germany. Examples were given of contracts in the construction and shipbuilding industries and export contracts for goods such as commodities and equipment. It was also noted that the same issue arises from the buyer's perspective (eg for purchases of property, plant and equipment (PPE)).

Question 2: Which exchange rate is used to recognise revenue in practice?

28. None of the respondents observed (or supported) the common use of View A (recognise revenue using the exchange rate at the date an enforceable contract is entered into).

29. About half of the respondents commenting on this question had observed mixed practice between View B (date of advance payment) and View C (date of recognition of revenue) for the recognition of revenue when a non-refundable payment is received in advance.

30. The majority of the other respondents indicated that common practice was to follow View B. Two respondents indicated that in their experience prevalent practice was to apply View C. However, one of these respondents also noted that in cases in which an entity had hedged the rest of the contract, the revenue relating to the prepaid amount was also recognised using the exchange rate at the date of

receipt of the advance payment (ie using View B), which generally coincided with the hedged exchange rate for the rest of the contract.

31. Some respondents noted that they had encountered difficulties in practice in determining whether the advance payment gave rise to a non-monetary or monetary item in accordance with IAS 21. They noted that it depended upon the terms of specific contracts and in particular on the conditions in which an advance payment might be refundable. These respondents noted that when deferred revenue was considered to be a monetary item and retranslated at each reporting balance sheet date, the revenue would be recognised using the spot rate at the date of transfer of the goods or services (ie View C). However, for the purposes of this paper, we have assumed that the terms of the contract are such that the advance payment is non-refundable and hence the deferred revenue is a non-monetary item. We are doing this to highlight the issue raised by the submitter (ie the interpretation of 'date of transaction' in paragraph 22 of IAS 21).

Question 3: Any change expected on application of IFRS 15?

32. About half the respondents commented on the application of IFRS 15. About half of these did not expect any changes as a consequence of applying IFRS 15, indicating that the diversity in practice is expected to continue. One respondent noted that IFRS 15 does not contain any foreign exchange requirements.

33. The other respondents commenting on the application of IFRS 15 thought that there may potentially be some changes on the application of IFRS 15, particularly because of the measurement requirements in IFRS 15 in respect of significant financing components. This is discussed further in paragraphs 50-56 of this paper.

Staff technical analysis

34. The issue is the interpretation of the words 'the date the transaction first qualifies for recognition in accordance with IFRSs' in paragraph 22 of IAS 21.

35. As noted in the outreach, diversity in practice currently exists, ie before the application of IFRS 15, indicating that it is not an IFRS 15-specific issue.

However, the submission is specifically concerned with the treatment of revenue transactions denominated in a foreign currency. Therefore, to the extent that IAS 21 is unclear, it is helpful to refer to the requirements in IFRS 15 for the recognition and measurement of revenue to consider whether it helps to interpret IAS 21.

36. We note that IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2017. Hence, it is appropriate to conduct our analysis on basis that IFRS 15 is applicable. This will ensure that any potential solution will survive the adoption of IFRS 15.

37. Consequently, in this section:

    (a) we first consider the requirements in IAS 21, as noted in paragraph 34; and

    (b) we take a look at the interaction of the issue with the measurement requirements in IFRS 15.

38. We also considered whether the issue would be more appropriately addressed by the Revenue Transition Resource Group (RTRG). Having spoken to the IASB staff of the RTRG, we decided against this, because the issue is primarily concerned with interpreting IAS 21. We understand that when developing IFRS 15, the intention was that foreign currency aspects of contracts with customers would be dealt with in IAS 21, as the more specific standard for foreign currency matters.

What does IAS 21 mean by 'the date the transaction first qualifies for recognition in accordance with IFRSs'?

39. There are two elements of the definition of 'the date of transaction' in paragraph 22 of IAS 21 that are explored further below:

    (a) 'the transaction'; and

    (b) 'first qualifies for recognition in accordance with IFRSs'.

What is 'the transaction'?

40. For the contract under discussion, there are two different ways of approaching what 'the transaction' is for the purposes of determining which exchange rate should be used to recognise revenue:

    (a) The 'one-transaction' approach: entering into the contract; transferring the goods or services; and receipt of cash payment are all part of the same transaction. This is consistent with Views A and B.

    (b) The 'multi-transaction' approach: entering into the contract; transferring the goods or services; and receipt of cash payment are separate transactions, each of which needs to be considered separately as to whether it qualifies for recognition in accordance with IFRSs. This is consistent with View C.

41. 'The transaction' is not explicitly defined in IAS 21 or elsewhere in IFRS. Paragraph 20 of IAS 21 states that 'a foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity: (a) buys or sells goods or services whose price is denominated in a foreign currency…'. However we do not think that this helps to identify whether a 'one-transaction' or 'multi-transaction' approach should be applied to revenue transactions.

42. Proponents of the multi-transaction approach argue that transferring goods or services and receiving payment are two distinct events that trigger the recognition of revenue or cash respectively. They note that the criteria for recognition of revenue in IAS 18, IAS 11 and IFRS 15 are independent from the timing of the payment for those goods or services.

43. Proponents of the one-transaction approach argue that it is consistent with the notion that revenue contracts represent exchange transactions. That is the payment and transfer of goods or services are inherently interdependent. This is consistent with the way in which IFRS 15 uses the term 'transaction' in the

definition of transaction price as an *exchange* of consideration for the transfer of goods or services.[3]

44. We think that IAS 21 is not entirely clear whether 'the transaction' refers to the one-transaction approach or the multi-transaction approach.

What does 'first qualifies for recognition in accordance with IFRSs' mean?

45. Paragraph 105 of IFRS 15 clarifies that when either party to a contract has performed, the entity shall present the contract in the statement of financial position as a contract asset or contract liability. Before either party to the contract has performed, nothing is recorded in the financial statements (provided that the contract is not onerous).[4] Paragraph BC51 of IFRS 15 explains that 'an entity's rights and obligations in wholly unperformed non-cancellable contracts are measured at the same amount and, therefore, would offset each other at inception. However, by including those contracts within the scope of IFRS 15, an entity would provide additional information…, that is disclosing…'.[5]

46. The issue, therefore, is whether an enforceable executory contract 'qualifies for recognition', even though it is not recorded in the financial statements because it is initially measured at zero. Such a view would be consistent with View A.

47. On the other hand, 'first qualifies for recognition in accordance with IFRSs' implies that the transaction should be recognised *in the financial statements* (ie with a value) when required by IFRS. In such a case, an enforceable executory contract with a customer (that is not onerous) would not 'qualify for recognition in accordance with IFRSs', because it would be not recognised in the financial statements in accordance with IFRS 15.

48. We note that the wording 'first qualifies for recognition in accordance with IFRSs' was inserted when IAS 21 was revised in 2003. On reviewing the staff

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[3] Appendix A of IFRS 15 defines transaction price as 'the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods and services to a customer…'.

[4] We note that paragraph 4.46 of the *Conceptual Framework* similarly states that 'In practice, obligations under contracts that are equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements'.

[5] This is also consistent with the IASB's tentative agenda decision on the *Conceptual Framework* project. See Agenda Paper 10D for the IASB meeting in June 2014 and the IASB *Update* for June 2014.

papers from that time, the issue it was addressing was whether the date of the transaction was the date of change of ownership (triggering the recognition of revenue or a disposal of an asset) or the date of an irrevocable commitment (such as an enforceable contract with customers). The staff noted that 'At its meeting in April 1998, the SIC agreed that the date of recording the transaction (change of ownership) is decisive'. The intention therefore was to use the date on which the transaction is initially recorded in the financial statements with a value in accordance with IFRS.

49. Hence, we think that on application of IFRS 15 an enforceable executory contract does not meet the 'first qualifies for recognition' condition in IAS 21, although disclosure is required in accordance with IFRS 15.

Interaction with the measurement requirements in IFRS 15

50. IFRS 15 does not explicitly discuss the foreign currency aspects of contracts with customers. This is because IAS 21 is the more specific standard for accounting for the foreign currency effects of transactions. However given that we think that IAS 21 is not entirely clear in this respect, it is worth considering the measurement requirements in IFRS 15 to see if they might help interpret paragraph 22 of IAS 21.

51. IFRS 15 contains general guidance on the measurement of revenue.[6] Paragraphs 46 and 47 of IFRS 15 state the following:

> 46 When (or as) a performance obligation is satisfied, an entity shall recognise as revenue the amount of the transaction price…that is allocated to that performance obligation.
>
> 47 An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of

[6] Similarly IAS 11 and IAS 18 do not explicitly discuss the foreign currency aspects of construction contracts and agreements to sell goods or render services. Both Standards state that revenue is measured 'at the fair value of the consideration received or receivable' (paragraph 12 of IAS 11 and paragraph 9 of IAS 18).

> consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer…

52. In terms of functional currency, the amount that the entity 'expects to be entitled' under the terms of the contract may be considered to be the foreign currency amount at the spot rate at the date of receipt of payment. For payments in arrears, at the date of recognising the revenue, the best estimate of the future exchange rate is generally considered to be the current spot rate. Arguably, for payments in advance, the amount of consideration in the functional currency is known by the time the revenue is recognised—it is the spot rate at the date of the prepayment. This implies that the revenue should be recognised using the spot rate at the date the cash is received for advance payments (ie View B). This approach reflects the fact that the entity is no longer exposed to foreign exchange risk after it has received the cash.

53. However, IFRS 15 treats payments in advance, or arrears, that have a significant financing component, as being similar to a fixed rate loan:[7]

> 61 The objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (ie the cash selling price).
>
> 63 As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and

[7] By contrast, IAS 18 only explicitly refers to imputing interest when the cash payment is deferred. Paragraph 11 of IAS 18 states that 'In most cases, the consideration is in the form of cash or cash equivalents and the amount of revenue is the amount of cash or cash equivalents received or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. …When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest…'.

> when the customer pays for that good or service will be one year or less.
>
> 64 To meet the objective in paragraph 61 when adjusting the promised amount of consideration for a significant financing component, an entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. That rate would reflect the credit characteristics of the party receiving financing in the contract, as well as any collateral or security provided by the customer or the entity, including assets transferred in the contract. An entity may be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the price that the customer would pay in cash for the goods or services when (or as) they transfer to the customer. After contract inception, an entity shall not update the discount rate for changes in interest rates or other circumstances (such as a change in the assessment of the customer's credit risk).

54. Applying the principle in paragraph 61 of IFRS 15 to a contract that is denominated in a foreign currency implies that revenue should be recognised using the spot rate at the date the goods or services are transferred to the customer. This is as if the customer had paid the foreign currency cash at that date, which is similar to View C.

55. The logical extension of treating the advance payment as a foreign currency financing component is to retranslate the contract liability to recognise foreign exchange gains and losses over the period of the 'foreign currency denominated loan' (ie from receipt of cash to recognition of revenue). This would be treating it as if it was a monetary item similar to a loan. However this would be inconsistent with treating the contract liability as a non-monetary item in accordance with paragraphs 8, 16 and 23 of IAS 21, on the basis that it represents an obligation to transfer goods or services and therefore cannot be retranslated at each reporting date.

56. We also note the optional practical expedient in paragraph 63 of IFRS 15 not to accrue interest, or recognise it as part of revenue, when payment is within a year of performance. Hence, we think that in practice there would be a narrow set of circumstances, which we do not expect to be widespread, in which advance payments might be treated as being similar to a fixed rate loan on application of IFRS 15.

Staff conclusions on technical analysis

57. In summary:

    (a) IAS 21 is not entirely clear. IAS 21 does not define ‘the transaction’ and therefore it is possible to read it as applying separately to the receipt of cash and transfer of goods or services (the multi-transaction approach) or treat the different events under the contract (eg receipt of cash and transfer of goods or services) as one unit of account, that is, as part of the same transaction (the one-transaction approach).

    (b) For contracts in which payment is in advance, IFRS 15 could be read as indicating that IAS 21 should be interpreted such that revenue should be measured at either the spot rate at the date of the advance payment or at the spot rate at the date of recognition of the revenue.

    (c) We think that for a transaction to ‘qualify for recognition in accordance with IFRSs’, the transaction must be recorded in the financial statements with a value. In accordance with IFRS 15, the transaction(s) are presented in the financial statements only after one of the parties has performed under the contract.

58. Based on the above, our conclusions are:

    (a) View A is not appropriate, because until one of the parties to the contract has performed, the contract does not qualify for recognition in accordance with IFRS 15.

(b) IAS 21 is not entirely clear on whether revenue should be recognised using the exchange date at the date of the advance payment (View B) or at the date of recognition of the revenue (View C).

59. As for Views B and C, we think that View B (the 'one-transaction' approach) is a more appropriate interpretation of IAS 21, because:

(a) it reflects the fact that an entity is no longer exposed to foreign exchange risk once it has received the cash; and

(b) the obligation to transfer goods or services (which gives rise to deferred revenue on recognition of an advance cash receipt) and the performance of that transfer (which gives rise to revenue) are not two independent transactions.

Question 1 for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff's technical analysis summarised in paragraphs 57-59 above?

Agenda criteria assessment

60. Please refer to Appendix C of this Agenda Paper for details of the Interpretations Committee's agenda criteria and an assessment of this issue against the agenda criteria.

61. In summary, we think that the agenda criteria are met for the following reasons:

(a) outreach indicates that it is a common issue across a number of jurisdictions and particularly within the construction industry;

(b) outreach indicates that there is diversity in practice, with both View B and View C being commonly adopted and responses to the outreach suggest that this diversity is expected to continue after the application of IFRS 15;

(c) the issue is limited to an interpretation of one paragraph of IAS 21, although it may have consequences for other contracts in addition to

sales contracts (eg purchases of PPE, inventory, intangible fixed assets, services);

(d) the *Conceptual Framework* does not address foreign currency transactions and therefore any solution would not contradict the *Conceptual Framework*; and

(e) any solution is likely to be effective for a reasonable time period, both because it would apply under IFRS 15 and because the IASB's research project on foreign currency transactions has been moved onto a longer-term basis.

Staff recommendation

62. Outreach indicates that issue is widespread and practice is diverse between Views B and C. The staff judge that the issue is sufficiently narrow and discrete that the Interpretations Committee should be capable of addressing it through an interpretation of IAS 21.

63. There could be consequences for the accounting treatment of other transactions denominated in a foreign currency, but we do not think that this should stop us from addressing this particular situation. As part of our work we will need to consider whether it is appropriate to widen the scope of any possible Interpretation. For example, there is nothing specific in IAS 2 *Inventories* or IAS 16 *Property, Plant and Equipment* regarding which exchange rate should be used to recognise Inventories or PPE.

Question 2 for the Interpretations Committees
2. Does the Interpretations Committee agree with the staff's recommendation to add this issue to its agenda, with a view to developing an interpretation?

Appendix A—Submission

Determining the Date of a Transaction when Reporting Foreign Currency Transactions in the Functional Currency

IAS 21 includes the following guidance for the translation of foreign currency transactions in the functional currency:

IAS 21.21 A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction [Refer: paragraph 22].

IAS 21.22 The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with IFRSs. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

Assume the following example to illustrate the issue:

Example 1

On January 1, 20X1 an entity with the functional currency US Dollar enters into two contracts that are both denominated in Euro.

Contract 1

This contract is for a product at a price of € 1,000. The customer makes a non-refundable pre-payment of the contractual amount of € 1,000 on May 15, 20X1. The product is delivered to the customer on July 15, 20X1.

Contract 2

This contract is for the rendering of a service at a price of € 1,000. The service will be rendered on a straight-line basis during the 3rd and 4th quarter of 20X1 (equally from July 1 to December 31). The customer makes a non-refundable pre-payment of € 1,000 on May 15, 20X1.

The relevant exchange rates during 20X1 are as follows:

	Exchange Rate
January 1, 20X1	€ 1: $ 1.00
May 15, 20X1	€ 1: $ 1.10
July 15, 20X1	€ 1: $ 1.15
Avg. exchange rate during the 3rd quarter 20X1	€ 1: $ 1.15
Avg. exchange rate during the 4th quarter 20X1	€ 1: $ 1.20

An entity may understand the guidance of IAS 21 in the following way which results in the below accounting:

View A – Freezing the rate throughout the transaction

Under this view the entity determines the date of the transaction per IAS 21.22 as follows: for both contracts it concludes that January 1, 20X1 is the date of the transaction since that is the date when both contracts are entered into (i.e. become legally binding and enforceable) and thus qualify for recognition in accordance with IFRSs. The entity applies the principles of IAS 18 for this purpose (IAS 18.13 *Identification of the transaction*[8]). Note that at the outset of the transaction revenue cannot be recognized because the risks and rewards associated with the good in contract 1 have not been transferred, and because the stage of completion for the service in contract 2 is nil. Despite the fact that the criteria for the recognition of *revenue* are not satisfied at the outset of the transactions, the recognition of the *transactions* themselves is possible[9]. These views are in-line with the positions taken within the IASB's Conceptual

[8] IAS 18.13, IFRIC 13, and IFRIC Updates clarify issues around the combination and separation of transactions.

[9] Some entities present the transaction at this stage "gross" on the balance sheet through a Trade Receivable entry and a corresponding Deferred Revenue entry. These entries are commonly triggered in the accounting systems through the issuance of an invoice. Other entities may use a "net" presentation method and not present anything on the balance sheet since at this stage the net position of the transaction is nil. IFRS 15 *Revenue from Contracts with Customers* contains detailed guidance around the presentation of contract assets and contract liabilities on the balance sheet and will provide clarity in the future. Further, IFRS 15.12 clarifies that *For the purpose of applying this Standard, a contract does not exist if each party to the contract has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party (or parties). A contract is wholly unperformed if both of the following criteria are met:*

(a) the entity has not yet transferred any promised goods or services to the customer; and

(b) the entity has not yet received, and is not yet entitled to receive, any consideration in exchange for promised goods or services.

IFRS 15 defines a contract as *An agreement between two or more parties that creates enforceable rights and obligations.*

Framework project in the area of asset and liability definitions for executory contracts (see Appendix for details). On that basis (see paragraph 64(a) of the Staff Paper) the entity concludes that on January 1, 20X1 it has an enforceable executory contract and *an enforceable executory contract contains a right and an obligation to exchange economic resources (or to pay or receive the difference in values between two economic resources if the contract will be settled net). The combined right and obligation constitute a single asset or liability.*
Accordingly, the entity uses the exchange rate at the outset of the contract for initial recognition of the transaction (€ 1: $ 1.00). When the entity receives the non-refundable pre-payment of € 1,000 on May 15, 20X1 it records the Cash received along with a corresponding Deferred Revenue entry and applies the exchange rate at the outset of the contract for initial recognition of the Deferred Revenue (DR Cash $ 1,100 / CR Deferred Revenue $ 1,000; CR FX-Gain $ 100). In accordance with IAS 21.23(b), at the end of the 2nd quarter the Deferred Revenue position is not re-measured since it is a non-monetary item; while Cash received (a monetary item) is translated using the closing rate of the period. On July 15, 20X1 as the product under contract 1 is delivered to the customer, the entity recognizes $ 1,000 in Revenue through the "amortization " of Deferred Revenue into Revenue and thus applying the exchange rate at the outset of the transaction (€ 1: $ 1.00). Similarly, for contract 2 the entity recognizes $ 500 as Revenue in each of the 3rd and 4th quarters for services rendered.

In contrast, some other reporting entity may understand the guidance of IAS 21.22 in the following way which results in the below accounting which is different from the accounting under View A above:

View B – Freezing each Deferred Revenue entry when payment is received

Under this view the entity determines the date of the transaction per IAS 21.22 as follows: the transaction date is the date when revenue is recognized, i.e. when the risks and rewards associated with the product are transferred to the customer, and as the service is rendered. If the customer would not make a non-refundable prepayment, the entity would recognize revenues of $ 1,150 for the product, and in total revenues of $ 1,175 (€ 500 * 1.15 + € 500 * 1.2) for the service. Because the entity receives the non-refundable prepayment in the above example, Deferred Revenue items of $ 1,100 (€ 1,000 * 1.1) are recognized upon cash receipt for each of the contracts. These Deferred

Revenue items represent non-monetary items since they are non-refundable and therefore, these would not be remeasured at period end if any changes in currency rates occur. On July 15, 20X1 the product is delivered and the entity recognizes Revenues of $ 1,100 (DR Deferred Revenue / CR Revenue). During the 3rd and 4th quarter the services are rendered and the entity recognizes Revenues of $ 550 per quarter. As a consequence, if for contract 2 pre-payments are received at different times (e.g. if the contract foresees a 50% pre-payment at the outset and 50% at the beginning of the 4th quarter), each payment triggers the recognition of a separate Deferred Revenue item and the corresponding recognition of Revenue resulting from the amortization of the respective Deferred Revenue item will lead to different Revenue amounts caused by the differences in exchange rates between the times of initial recognition of Deferred Revenue.

In contrast to above, some other reporting entity may understand the guidance of IAS 21.22 in the following way which results in the below accounting which is different from the accounting under View A and View B above:

View C - Freezing each Deferred Revenue entry when triggered through invoicing but recognizing Revenue based on actual rates

Under this approach the entity determines the date of the transaction per IAS 21.22 as follows: the entity focusses on the timing of recognition of *revenues* (when the criteria of IAS 18 are fulfilled) and applies the spot exchange rate at the date of Revenue recognition. Accordingly, Revenue for the delivery of the product under contract 1 is recorded at the exchange rate on July 15, 20X1, resulting in Revenue of $ 1,150. Similarly, for the services rendered under contract 2, the entity records $ 575 as Revenue for the 3rd quarter and $ 600 for the 4th quarter. With this method upon receipt of the non-refundable pre-payment of € 1,000 which leads to the initial recognition of Deferred Revenue at $ 1,100, the amount presented as Deferred Revenue deviates from the amount subsequently recoded as Revenue ($ 1,150). Accordingly, upon amortization of Deferred Revenue into Revenue, exchange gains or losses are realized.

The table below provides an overview of Revenues recognizes under the different methods:

	View A	View B	View C
Revenue recognized for contract 1 (product)	$ 1,000	$ 1,100	$ 1,150
Revenue recognized for contract 2 (service)	$1,000	$ 1,100	$ 1,175

Example 2

Assume the same exchange rates as in Example 1.

On January 1, 20X1 an entity with the functional currency US Dollar enters into a contract with a customer for 2 products. The contract is in a foreign currency (EUR) and the price for each product is EUR 1,000 (total consideration of EUR 2,000). The entity issues a separate invoice for each product upon delivery, and the payment for each product is due 30 days after delivery. The entity delivers the first product on January 1, 20X1 and recognizes USD 1,000 (= EUR 1,000) as Revenue and records a corresponding Trade Receivable of USD 1,000. On July 15, 20X1 the entity delivers the second product. Question: How much revenue does the entity recognize for the second product?

View A – Freezing the rate throughout the transaction

Under this view the entity determines the date of the transaction per IAS 21.22 as follows: it concludes that January 1, 20X1 is the date of the transaction since that is the date when the contract is entered into (i.e. becomes legally binding and enforceable) and thus qualifies for recognition in accordance with IFRSs. At the outset of the transaction Revenue can only be recognized for the first product because the risks and rewards associated with the second product have not yet been transferred. Despite the fact that the criteria for the recognition of all of *revenue* of the contract are not satisfied at the outset of the transaction, the recognition of the *transaction* itself is possible. Accordingly, the entity uses the exchange rate at the outset of the contract for the initial recognition of the transaction and that exchange rate is applied also to the recognition of Revenue for the second product on July 15, 20X1 upon delivery. The entity recognizes USD 1,000 in Revenue for the second product.

View B – Freezing each Deferred Revenue entry when payment is received

Under this view the entity determines the date of the transaction per IAS 21.22 as follows: the transaction date is the date when revenue is recognized, i.e. when the risks and rewards associated with each product are transferred to the customer. Because the entity issues an invoice for each product upon delivery, it does not recognize Deferred Revenue but rather Revenue (depending on the accounting system in use, the entity might nevertheless record Deferred Revenue upon issuance of the invoice which is immediately followed by a further entry that converts the Deferred Revenue into Revenue). On July 15, 20X1 the entity recognizes Revenue of $ 1,150.

View C - Freezing each Deferred Revenue entry when triggered through invoicing but recognizing Revenue based on actual rates

Under this approach the entity determines the date of the transaction per IAS 21.22 as follows: similar to View B, the entity focusses on the timing of recognition of *revenues* (when the criteria of IAS 18 are fulfilled) and applies the spot exchange rate at the date of Revenue recognition. Accordingly, Revenue for the delivery of the second product is recorded at the exchange rate on July 15, 20X1, resulting in Revenue of $ 1,150.

The table below provides an overview of Revenues recognizes under the different methods:

	View A	View B	View C
Revenue recognized for first product	$ 1,000	$ 1,000	$ 1,000
Revenue recognized for second product	$ 1,000	$ 1,150	$ 1,150

Reasons for the IFRS Interpretations Committee to address the issue

(a) Is the issue widespread and has, or is expected to have, a material effect on those affected?

We believe the issue is widespread and is expected to have a material effect on those affected. The reasons are that i. entering into foreign currency transactions is a common business practice, and ii. the fluctuation of exchange rates between the transaction

currency and the functional currency of the entity can be significant and thus have material effects.

(b) Would financial reporting be improved through the elimination, or reduction, of diverse reporting methods?

We believe that through the clarification of the above issue financial reporting of affected entities would improve.

(c) Can the issue be resolved efficiently within the confines of IFRSs and the Conceptual Framework for Financial Reporting?

Yes, we believe that the issue can be resolved by providing additional clarification around the date of the transaction for foreign currency revenue transactions.

(d) Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process?

Yes, we believe the issue is sufficiently narrow in scope since it ultimately relates to one paragraph of IAS 21 (IAS 21.22 for the definition of the date of a transaction). However, the issue is not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process since a broad range of revenue generating transactions are affected, i.e. all foreign currency transactions of entities where there is a time gap between entering into the transaction and recognizing revenues.

(e) Will the solution developed by the Interpretations Committee be effective for a reasonable time period? The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified.

We believe the issue is not only relevant under current revenue recognition guidance within IFRSs (IAS 11, 18), but also after IFRS 15 *Revenue from Contracts with Customers* becomes effective. While IFRS 15 provides guidance for the identification of the contract and for the recognition of revenues, we believe that without additional clarification around the date of the transaction (in IAS 21) the issue will continue to lead to diversity in practice also after entities adopt IFRS 15.

Appendix

IASB Conceptual Framework Project—Staff Paper 10D June 2014

AP10D-Conceptual Framework.pdf

Minutes of the June 2014 Board meetings:

Asset and liability definitions—executory contracts (Agenda Paper 10D)

The IASB tentatively decided that the *Conceptual Framework* should include concepts explaining the nature of the assets and liabilities in executory contracts. It should state that:

a. an enforceable executory contract contains a right and an obligation to exchange economic resources (or to pay or receive the difference in values between two economic resources if the contract will be settled net). The combined right and obligation would constitute a single asset or liability; and
b. if an entity enters into a forward contract to purchase a resource at a future date, the entity's asset is normally its right to buy the underlying resource, not the underlying resource itself. However, in some circumstances the terms of a forward contract to purchase a resource may give the purchaser control of that resource. In such circumstances, the purchaser should identify both an asset (the underlying resource that it already controls) and a liability (its obligation to pay for the resource). In these circumstances, the contract is not executory: the seller has substantively performed its obligations.

Thirteen IASB members agreed with these decisions.

The IASB tentatively decided that the *Conceptual Framework* should not address the measurement of executory contract assets and liabilities. Instead, the IASB should apply the general measurement concepts in the *Conceptual Framework* when specifying requirements for particular types of executory contract within the applicable Standard. All IASB members agreed with this decision.

The IASB noted that many existing Standards implicitly apply the same measurement bases for executory contract assets or liabilities as they specify for the assets or liabilities that arise when one of the parties subsequently performs its obligations. The result is that many executory contract assets and liabilities are measured at zero (and hence are not recognised) unless the contract is onerous.

Complementary Information—IAS 21 and the Balance Sheet Presentation Model of IFRS 15

IAS 21 clarifies that all transactions of an entity that are not denominated in the entity's functional currency are considered foreign currency transactions. Exchange differences arising on translation are generally recognized in profit or loss. Foreign currency transactions are translated to the functional currency of the entity as follows:

Translation at the transaction date (initial recognition)

Each foreign currency transaction is recorded in the entity's functional currency at the rate of exchange at the date of the transaction, or at rates that approximate the actual exchange rates. An average exchange rate for a specific period may be a suitable approximate rate for transactions during that period, particularly when exchange rates do not fluctuate significantly (IAS 21.21, 22).

Translation at the reporting date (reporting at the ends of subsequent reporting periods)

At the reporting date assets and liabilities denominated in a currency other than in the entity's functional currency are translated as follows:

Monetary items are translated at the exchange rate at the reporting date;

Non-monetary items measured at historical cost are not retranslated; they remain at the exchange rate at the date of the transaction;

Non-monetary items measured at fair value are translated at the exchange rate when the fair value was determined (IAS 21.23)

Monetary items: Are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency. The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include pensions and other employee benefits to be paid in cash; provisions that are to be settled in cash; and cash dividends that are recognized as a liability.

Non-monetary items: In contrast to monetary items, the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: amounts prepaid for goods and services (e.g. prepaid rent); goodwill; intangible assets; inventories; property, plant

and equipment; and provisions that are to be settled by the delivery of a non-monetary asset.

When combining the existing requirements of IAS 21 with the balance sheet presentation model of IFRS 15 (an asset and liability approach with the net contract position presented on the balance sheet), items of the financial statements are translated to the functional currency of the entity as follows (assuming the functional currency is the presentation currency):

B/S Item (in the context of IFRS 15 contracts with customers)	Monetary Item(M) /Non-Monetary (NM) Item	Fx Measurement upon Initial Recognition (fx rate of…)	Fx Re-measurement at Reporting Date?
Assets Recognized from the Costs to Obtain or Fulfil a Contract	NM	Transaction Date (when costs are capitalized)	No
Contract Asset	M	Transaction Date	Yes (following IFRS 9/IAS 39 as Financial Instrument)
Receivable	M	Transaction Date	Yes (following IFRS 9/IAS 39 as Financial Instrument)
Cash (collection of a Receivable)	M	Transaction Date	Yes
Cash (receipt of a prepayment of a non-refundable contract)	M	Transaction Date	Yes
Cash (receipt of a prepayment of a refundable contract)	M	Transaction Date	Yes
Contract Liability	NM	Transaction Date	No

B/S Item (in the context of IFRS 15 contracts with customers)	Monetary Item(M) /Non-Monetary (NM) Item	Fx Measurement upon Initial Recognition (fx rate of…)	Fx Re-measurement at Reporting Date?
Refund Liability (for the receipt of a prepayment in a contract with a return right)	M[10]	Transaction Date	Yes
Refund Liability (for expected goods to be returned in a contract with a return right)	M[11]	Transaction Date	No
Onerous Contract Liability (IAS 37)	NM	Transaction Date	No (unless costs incur in foreign currency)

[10] Measurement of the refund liability follows the measurement of the related receivable

[11] Measurement of the refund liability follows the measurement of the related receivable

Appendix B: Illustrative example

An entity has a functional currency of £ and enters into an uncancellable contract at time T0 to sell goods to a customer for $100. Under the contract the customer prepays for the goods at time T1 and the entity performs under the contract (delivers the goods) at time T2.

Illustrative exchange rates are as follows:

T0 (enter into contract)	$100 = £110
T1 (cash received)	$100 = £115
T2 (goods delivered)	$100 = £117

Time	View A	View B	View C
T0 (enter into contract)	-	-	-
T1 (cash received)	Dr Cash £115 Cr Deferred rev £110 Cr p/l (fx) £5	Dr Cash £115 Cr Deferred rev £115	Dr Cash £115 Cr Deferred rev £115
T2 (goods delivered)	Dr Deferred rev £110 Cr Revenue £110	Dr Deferred rev £115 Cr Revenue £115	Dr Deferred rev £115 Cr Revenue £117 Dr p/l (fx) £2
Observations	At date when cash is received (T1), recognise fx gain which relates to movements in exchange rate from inception of contract to date receive cash (ie for the period T0-T1). The exchange rate used to recognise revenue is independent of the timing of the cash payment.	No fx gains or losses recognised if cash paid in advance of delivery of goods. (If cash received in arrears then recognise fx on receivable for period from delivery to settlement.) The exchange rate used to recognise revenue depends upon whether cash is paid in advance (and if so the timing of that payment) or in arrears.	Recognise fx loss at T2, which relates to movements in exchange rate on deferred revenue over period T1-T2. (If cash received in arrears get same accounting as under View B.) The exchange rate used to recognise revenue is independent of the timing of the cash payment.

Appendix C—Assessment against the Interpretations Committee's agenda criteria

C1. Below we have assessed the issue against the agenda criteria of the Interpretations Committee as described in paragraphs 5.14–5.22 of the IFRS Foundation *Due Process Handbook*.

Criteria	
We should address issues(5.16):	
that have widespread effect and have, or are expected to have, a material effect on those affected;	Yes. Outreach indicates that the issue is prevalent in many jurisdictions, particularly in the construction industry, and it may have a significant effect.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and	Yes. Outreach indicates that there is diversity in practice, with both View B and View C applied. Furthermore, outreach suggests that this diversity is expected to continue after the application of IFRS 15.
that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*.	Yes. Foreign exchange is not addressed in the *Conceptual Framework* or IFRS 15 and therefore the issue could be addressed through an interpretation of the term 'the date of transaction' in paragraph 22 of IAS 21. We will need to consider the consequences for other foreign currency-denominated transactions with advance payments (eg purchases of PPE, inventories, services).

In addition:	
Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process that would be required when making changes to IFRSs (5.17)?	Yes (see discussion above).
Will the solution developed by the Interpretations Committee be effective for a reasonable time period (5.21)? (The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified).	Yes. The solution should apply after application of IFRS 15. Furthermore, the IASB decided in October 2014 to move its research item on foreign currency translation onto a longer-term basis.